
KRAMON & GRAHAM PA

ONE SOUTH STREET, SUITE 2600
BALTIMORE, MD 21202-3201

MEMORANDUM

DATE: August 18, 2017

TO: Maryland Building Industry Association

FROM: Jeffrey H. Scherr & John F. Dougherty, Kramon & Graham, P.A.

RE: Deferred Utility Charges

In Select Portfolio Servicing, Inc. v. Saddlebrook West Utility Co., LLC, ___ Md. ___, (Aug. 16, 2017), the Maryland Court of Appeals held that:

[T]he Declaration recorded by Saddlebrook did not itself create a lien on the property. Rather, Utility must follow the procedures set forth in the Maryland Contract Lien Act, Maryland Code, Real Property Article (“RP”), §14-201 et seq., to establish a lien under the Declaration with respect to delinquent assessments – as it did on at least two occasions with respect to the particular property that is the subject of this case. The priority of that lien is determined by the date of its recording in the land records.

This memorandum discusses the implications of the decision for enforcement of existing and future utility declarations.

Limitations on the Select Portfolio Decision

The Court's decision does not necessarily apply to all utility declarations. Rather, it appears to be limited to declarations that share attributes with the Saddlebrook Declaration, including: (1) the establishment of the lien being delayed until the first sale to a non-builder lot owner; (2) the declarant and builder lot owners being excused from the obligation to pay utility charges; (3) the failure of the Declaration to state the amount of the lien; and (4) the failure to pay transfer and recordation taxes upon recordation of the declaration.

The Court of Appeals summarized the problematic aspects of the Saddlebrook Declaration as follows:

The Declaration, which provided for the granting of a lien by future homeowners to Utility to secure the payment of the annual assessment, purported to give priority to that lien at a date before the development was constructed or any homeowner had granted a lien under the terms of the Declaration.

Select Portfolio, slip op. at 2. The Court noted that "Saddlebrook and the builders of the homes in the Subdivision were explicitly excluded from the obligation to pay the annual assessment during the period of time that they owned lots." Select Portfolio, slip op. at 5. The failure to pay transfer and recordation taxes also clearly was significant to the Court:

At the time of recording, Saddlebrook appeared to treat the Declaration as a notice instrument and did not pay recordation or transfer taxes, as it would have if the Declaration itself established a lien. . . . Under the Tax-Property Article, a recordation tax is imposed on any instrument recorded in the land records based on the principal amount of the lien at the time of recordation. Maryland Code, Tax-Property Article, §§12-101(f)(1)(ii), 12-102, 12-105(f)(1). This is not to say that non-payment of those taxes would invalidate the lien, if the Declaration in fact created one. Rather, it is evidence that the developer itself did not perceive the recording as creating a lien.

Select Portfolio, slip op. at 30-31, n.31. The Court also noted that "[t]he Declaration did not state the value of the lien it sought to create." Id. at 5. Arguably, however, the Saddlebrook Declaration indirectly stated the value of the lien, by stating the amount of the annual payment, the term, and the discount rate for prepayment. It would be better and clearer, however, to perform the present value calculation using the annual amount, term, and prepayment discount rate.

The specific terms of the Saddlebrook Declaration provided as follows:

2. ESTABLISHMENT OF LIEN AND PERSONAL OBLIGATION. Each Owner of any Lot, other than the Declarant or any Builder, by acceptance of a deed therefor, whether or not it shall be so expressed in such deed, . . . (c) grants to the Utility Company a lien to secure payment of the aforesaid Water and Sewer Charges upon the Lot against which the aforesaid Water and Sewer Charges are assessed, and (d) grants to the Utility Company a power of sale, and assents to the entry of a decree and order for the sale of that Lot

.....
4. COMMENCEMENT DATE. The Water and Sewer Charges described herein shall commence (the "Commencement Date") with respect to each Lot on

the first (1st) day of the first (1st) January following the day of conveyance of such Lot from the Declarant or any Builder to any other Owner, other than the Declarant or another Builder. . . .

5. PRIORITY OF LIEN. The lien for all Water and Sewer Charges (including, without limitation, all interest, costs, late fees and attorneys' fees) provided for herein shall have priority from the date upon which this Declaration is recorded among the Land Records over any subsequently recorded or created lien, deed of trust, mortgage or other instrument encumbering any Lot. . . .

Many existing utility declarations are factually distinct from the Saddlebrook declaration, and those distinctions arguably could give liens under such declarations priority over a later-recorded mortgage lien. For example, our firm's standard form agreement provides that the lien exists upon recordation, and the payment obligation begins with the first lot sale¹:

2. ESTABLISHMENT OF LIEN AND PERSONAL OBLIGATION. Declarant and Utility Company hereby establish against each of the Lots a present and continuing lien as security for payment of the Water and Sewer Charges, and each Owner by acceptance of a deed therefor agrees to pay whether it is expressly set forth in such deed or not, the Water and Sewer Charge in the amount set forth in Section 4 below. The Water and Sewer Charges, together with accrued interest, costs, late fees, Collection Costs and Attorney's Fees and any other sums due, as provided herein, shall be a present and continuing lien against each Lot from the date of recordation hereof and such lien shall continue until all sums due hereunder have been fully satisfied. . . .

4. COMMENCEMENT DATE. The Water and Sewer Charges described herein shall commence (the "Commencement Date") upon the earlier to occur of the following: (i) the conveyance of each Lot from Declarant or a Declarant Affiliate to any other Owner other than Declarant or a Declarant Affiliate, or (ii) the date which is twenty (20) years after the date of recordation of this Declaration.

Similarly, our firm's form declaration does not include a clause excusing builder lot owners from paying utility charges. Finally, some counties (Howard, Baltimore

¹ We understand that many builders prefer to have the payment commencement date start with the first non-builder lot owner, but as set forth in the decision, that preference is inconsistent with the declaration lien having priority over later-recorded mortgages. The cost of having the payment commencement date start with conveyance to a builder can be dealt with in the lot purchase agreement.

County) already require payment of transfer and recordation taxes on the value of the utility charges.

It is uncertain how the Court of Appeals would construe a declaration with attributes different from the Saddlebrook Declaration, but such declarations are sufficiently different to argue that they are not governed by the Select Portfolio decision.

Managing Collections Under Existing Utility Declarations

The Court did not address whether the Maryland Contract Lien Act is the sole and exclusive remedy for creating and enforcing liens under all utility declarations, but for declarations similar to the Saddlebrook Declaration, a utility company can enforce the payment obligation by obtaining a lien in Circuit Court using the Contract Lien Act, or by filing an action for breach of contract (typically a small claim action in District Court); the judgment in such an action would then entitle the utility company to obtain a judgment lien on all property of the homeowner, including the subject property, but as to the subject property such a lien would be second in line after any mortgage lien. For declarations that create an immediately enforceable lien, the utility company can file a breach of contract action in District Court, and also should be able to continue to use traditional foreclosure remedies. Obtaining a lien under the Contract Lien Act should only be used for Saddlebrook-type declarations that do not create an immediately enforceable lien, because, as the Court observed, obtaining a lien under the Contract Lien Act is inconsistent with the argument that a lien already existed under the declaration.

Many declarations contain an acceleration clause that can be invoked at the discretion of the utility company. When there is a payment default, the decision whether to invoke such a clause should be made on a case-by-case basis. For a Saddlebrook-type declaration, if the homeowner has a mortgage that has priority over the utility lien, the mortgage is in foreclosure, and the homeowner has little or no equity, acceleration of future payments could cause them to also be extinguished by the mortgage foreclosure. Opting to not accelerate in such cases would allow the utility company to continue to collect future payments.

Recommendations for Future Declarations

For future declarations, the declarant should draft the instrument to: (1) establish the lien immediately upon recordation; (2) require all lot owners, including builders, to pay utility charges; (3) use an early payment commencement date, such as when the utilities are completed or the lot is connected to the county or WSSC water and sewer system; (4) state the amount of the lien (net present value using the prepayment discount rate); and (5) the declarant should pay transfer and recordation taxes upon recordation of the declaration, in all counties, rather than just those that are currently requiring it (such as Howard and Baltimore Counties). For Saddlebrook-type declarations that have already been recorded, but where no lots have yet been sold to homeowners, the declarant should record an amended declaration incorporating any of the above recommendations that are not already in place.